Office of Chief Counsel Internal Revenue Service

memorandum

CC: NER: PEN: PHI: TL-N-5442-99

JCFee

date:

to: Chief, Quality Measurement Staff, Pennsylvania District Attn: Marshall Lyons

from: Assistant District Counsel, Pennsylvania District, Philadelphia

ubject:

EIN: Tax Years: Tax, and Computation Date for Accrual of Deficiency Interest

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

You have informally requested our legal advice on the proper date for computing deficiency interest where the taxpayer has elected to apply it overpayments of tax per return to the following year's estimated tax deposits.

ISSUE:

At what date does interest begin to run on a deficiency in tax for a particular year, where the taxpayer had previously reported an overpayment of tax on its return and elected to have the overpayment credited against its estimated tax liability for the succeeding year.

CONCLUSION

To the extent the taxpayer's deficiency results from an overpayment credit used to satisfy a subsequent year's estimated tax liabilities, deficiency interest will be assessed as of the dates the excessive overpayment credit is applied to the succeeding year's estimated taxes. Interest will be computed as of the original due date of the succeeding year's income tax return, if the excessive overpayment credit was not needed to satisfy specific installments of estimated tax.

FACTS

timely filed its tax return for the year ended April 30,

The return reflected an overpayment of \$, which elected to apply to the corresponding subsequent tax year's estimated taxes. Since did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter of the tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254. Accordingly, the Service applied the entire overpayment to the first estimated payment as of

On audit, the Service determined a deficiency of \$ for the (less than the amount of \$ for reported return overpayment). The \$ for deficiency was paid by the application of credits as of from prior tax years. The for date of application was the due date of the form tax return. The Service determined that deficiency interest was not due since the assessed deficiency of \$ form was considered paid as of the due date of the form return. The Service also determined that overpayment interest was not due on the \$ form of the deficiency.

TAX YEAR APRIL 30,

April 30, on the extended due date of return reflected an overpayment of which elected to apply to the subsequent tax year's (see) estimated tax liability. Since did not designate the quarterly installment to which the overpayment should be applied, the Service applied the

reported overpayments to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for in the amount of \$ (more than the reported return overpayments of \$ (more than the reported return on \$ (more than the reported return on \$ (more than the reported return on \$ (more than the reported return of \$ (more than th

TAX YEAR APRIL 30,

ended April 30, on the extended due date of the year ended April 30, on the extended due date of the return reflected an overpayment of which elected to apply to the corresponding subsequent tax year's () estimated taxes. Since did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On audit, the Service determined a net deficiency for in the amount \$ (less than the reported return overpayments of \$ for (less than the reported return deficiency interest would begin to run on deficiency, the Service concluded that interest should run from the deficiency, the due date of the first installment of estimated payments.

TAX YEAR APRIL 30,

ended April 30, on the extended due date of the return reflected an overpayment of which elected to apply to the corresponding subsequent tax year's () estimated taxes. Since did not designate the quarterly installment to which the overpayment should be applied, the Service applied the reported overpayment to the first quarter for the subsequent tax year, pursuant to Rev. Rul. 84-58, 1984-1 C.B. 254.

On Audit, the Service determined a deficiency for in the amount \$ ______, Which includes an advance payment of a proposed deficiency of \$ ______, (The total of \$ ______, is less than the reported return overpayments of \$ ______, for ______). In determining when deficiency interest would begin to run on _______, deficiency, the Service concluded that interest should run from _______, the due date of the first installment of estimated payments.

Claims For Refund

has now filed claims for refund for each of the tax years discussed herein. As to the year to based on the use of money principles with respect to payments received for payment of taxes not due and payable until application of the reported overpayments for the year the are not rendering an opinion as to the claim since the facts for this year do not fit into the normal "Sequa" type claim pattern. The year will be submitted for Field Service Advice and accordingly will be the subject of separate advice from our Office.

As to the years , and , with respect to the deficiency interest assessed and paid based on use of money principles, is takes the position, that since it did not need the entire overpayment to avoid the estimated tax penalty, interest should not begin to accrue until the overpayment is needed or used to pay the installment due. Based on the analysis submitted by with its claim, the overpayment is applied as follows:

	OVEPAYMENT	CREDIT	APPLIED	TO
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Installment Period	Installment Due	E/S Payment	Overpayment Credit Applied
	\$	\$	
	\$	\$	
	\$	\$	
	\$		

OVEPAYMENT CREDIT APPLIED TO

Installment Period	Installment <u>Due</u>	E/S Payment	Overpayment Credit Applied
	\$	\$	\$
	\$	\$	
	\$	\$	
	\$	\$	\$

OVEPAYMENT CREDIT APPLIED TO

Installment Period	Installment Due1	E/S Payment	Overpayment Credit Applied
	\$	\$	
	\$	\$	\$
	ş	\$	
	\$	\$	\$

¹ We are constrained to note that in performing an analysis of what portion of an overpayment is applied to a quarterly estimated payment to avoid the penalty, there is has been no effort by the Internal Revenue Service to verify the taxpayer's computations of required installments. In other words, the amount due is based entirely on the Forms 2220 as filed.

LAW AND ANALYSIS

Rev. Rul. 88-98, 1988-2 C.B. 356, holds that when a taxpayer elects to credit an overpayment from a return (i.e. the taxpayer makes a "credit elect') and the credit is applied in full against a particular installment of the succeeding year's estimated tax, interest on a subsequently determined deficiency for the earlier year runs from the due date of that installment on the part of the deficiency equal to or less than the credit elect. Rev. Rul. 88-98 follows Avon Products, Inc. v. United States, 588 F.2d 342 (2d Cir. 1978), in which the court interpreted section 6601(a) to mean that interest on a deficiency can only be charged when the tax is both due and unpaid. The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines when the prior year's tax became unpaid for purposes of section 6601(a), and thus when deficiency interest begins to run. Prior to that date the government has had the use of the funds with respect to the prior year's tax.

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997), the taxpayer elected to credit an overpayment shown on its 1983 tax return to the succeeding year's estimated tax liability but did not attach a statement to its return indicating the installment to which the Service should apply the credit. deficiency was determined for the taxpayer's 1983 tax year, and interest was assessed from the due date of the first installment in accordance with Rev. Rul. 88-98. However, the taxpayer had made estimated tax payments sufficient to avoid the addition to tax imposed by section 6655 for 1984 for the first and second installments. The court concluded the Service's application of taxpayer's 1983 overpayment to the first installment did not change the fact that the government had the use of taxpayer's overpayment from the due date of the first installment (May 15) to the date taxpayer filed its 1983 tax return (October 15), since the overpayment was not needed to satisfy any installment of estimated tax due during that period.

In Rev. Rul. 99-40, 1999-40 IRB 1, the Service reconsidered the manner in which deficiency interest is computed in light of the <u>May Department Stores</u> decision. When a taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes, the credit is applied to unpaid installments of estimated tax due on or after the date the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure

to pay estimated income tax under sections 6654 and 6655. The Service will assess interest on a subsequently determined deficiency from the date the credit is applied to the succeeding year's estimated taxes. The unused balance of the credit is deemed effective as a payment of the succeeding year's income tax liabilities as of the unextended due date of the return.

For tax year, the deficiency amount exceeded the overpayment claimed on the return and credited to the tax year. Therefore as a result of the deficiency, it was subsequently determined that the taxpayer had not actually been entitled to any part of the overpayment credit (i.e., the credit elect). Nevertheless, under May Department Stores and Rev. Rul. 99-40, the government is deemed to have had the use of the taxpayer's money (i.e., the credit elect amount) until the credit elect is applied to the subsequent year's estimated tax liability or the subsequent year's income tax liability.

To avoid the estimated tax penalty, did not need any of the \$ credit elect from the tax year. The \$ credit elect is deemed to apply to the income tax liability on the tax return. Accordingly, interest on \$ should begin to run on the due date of the return. Deficiency interest on the balance of the deficiency (\$ should run from the due date of the return, of course.

For tax years and the the credit elect amount was well in excess of the subsequently determined deficiencies. When the credit elect amount was well in excess of the subsequently determined deficiencies. When the credit elect amount was except and the credit elect amount was well in excess of the subsequently determined deficiencies. When the credit elect amount was well in excess of the subsequently determined as shown below:

The taxpayer also made estimated tax payments of \$ for and \$ for .

Since the was fully satisfied by (1) the credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made, none of the "excessive" credit elect that created its deficiency was used to satisfy the estimated tax liability. Accordingly, interest on the deficiency should begin to run on the due date of the return.

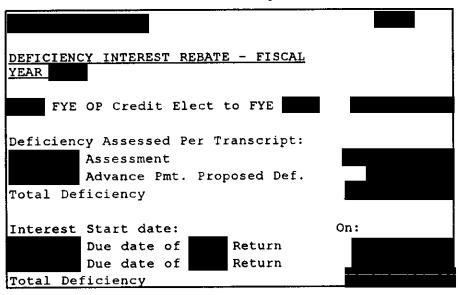
The estimated tax liability was satisfied as follows in accordance with Situation 2 of Rev. Rul. 99-40:

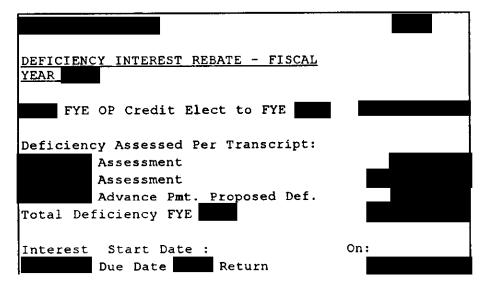
Installment <u>Period</u>	Installment Due	E/S Payment	Application of Credit Elect to which TP is ENTITLED	Application of Excessive Credit Elect
	\$	\$ (a)		
	ş	\$ (a)	ş	
	\$	(b)		
	\$	\$ (b)	\$ (c)	\$
Totals	\$	\$	\$	\$

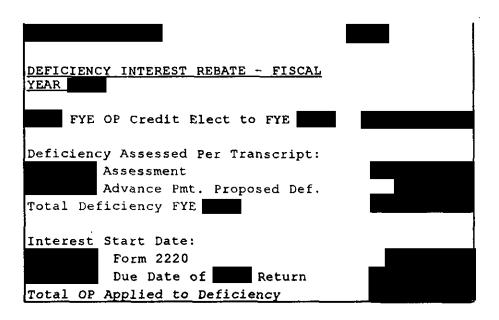
- (a) The taxpayer paid \$ for the first quarter, of which only \$ was required to satisfy the estimated tax liability; the balance of \$ was carried to the second quarter. The \$ when added to the second quarter estimated payment of \$ equals the \$ second quarter amount above.
- (c) This amount represents the balance of the \$ _____ credit elect from 9 of the fourth installment was satisfied by the "excessive" credit elect that created its _____ deficiency.

Except for \$ _____, the entire _____ estimated tax liability was satisfied by (1) the _____ credit elect to which the taxpayer was ENTITLED and (2) the estimated payments actually made. Accordingly, interest on \$ _____ of the _____ deficiency should begin to run on _____, the due date of the _____ deficiency (\$ _____ should begin to run on _____, the due date of the _____ return.

To summarize, deficiency interest shall be computed with reference to the following:







This concludes our advice and recommendation. Please feel free to call Attorney James C. Fee, Jr. at 215-597-3442 with any additional questions you may have. We are forwarding a copy of this advice to the Assistant Regional Counsel (Tax Litigation) (CC:NER) and to the Office of Assistant Chief Counsel (Field Service) (CC:DOM:FS) for mandatory 10 day post review. To assure that the National Office has had sufficient time to review our advice, we request that you refrain from taking any action with respect to the taxpayer's claim prior to

JOSEPH M. ABELE Assistant District Counsel

cc: Assistant Regional Counsel (Tax Litigation) (CC:NER)
 Office of Assistant Chief Counsel (Field
 Service) (CC:DOM:FS)